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STATUTE

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

JACK M. CHESBRO, CARL SILVERSTEIN, MORRIS SILVERSTEIN AND SMILING JACK CHESBRO, INC., *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners, Jack M. Chesbro, Carl Silverstein, Morris Silverstein and Smiling Jack Chesbro, Inc., respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on August 9, 1955, with a petition for rehearing denied on September 7, 1955.

OPINIONS BELOW

The opinion of the Tax Court is reported at 21 T.C. 123, and is set forth with its accompanying orders in the Record hereof* at pages 145-161, 177-184.

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* The Record herein, printed under the caption of this case in the United States Court of Appeals for the Second Circuit, bears the title "Appendix to Appellants' Brief on Appeal from the Tax Court of the United States," and has been filed with the present Petition.

The opinion of the United States Court of Appeals for the Second Circuit is reported at 225 Fed. 2d 674 (1955), and is set forth as Appendix A hereto.

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on August 9, 1955 (App. A, p. 1a). Rehearing was denied on September 7, 1955 (App. B, p. 2a). Justice Reed extended the time within which to file Petition for Writ of Certiorari to and including January 6, 1956 (App. C, p. 3a), and then to and including February 4, 1956 (App. C, p. 4a). The jurisdiction of this Court rests on 28 U.S.C. Sec. 1254 (1).

QUESTIONS PRESENTED

Petitioners were engaged in the business of buying and selling used cars during the years 1946 and 1947. During those years they felt themselves at times compelled, because of existing market conditions, to pay to those from whom they purchased cars, and to exact from those to whom they sold cars, cash beyond the ceiling prices established by the United States Office of Price Administration for such purchases and sales. This practice was common during that period among used car dealers in their vicinity. Petitioners presented evidence of specific transactions in which this took place. Evidence was also submitted by them, and they proffered additional evidence which was refused by the Tax Court, to show that their business during this period was characterized by a pattern, in which the total amount by which their records understated the money received by them for cars they sold was substantially equal to the total amount by which their

records understated the money they spent for cars they bought.

The corporate petitioner maintained a "revolving fund," which began with cash contributed in equal amounts by each of the three individual petitioners. This fund was used by them to pay cash required on their purchases of cars, and was replenished with cash received on their sales. Cash received into or expended from the fund by any one of the three individual petitioners was noted individually by him, and all three would meet every few days and adjust their accounts. No permanent records of these transactions were maintained.

During the course of the fiscal year commencing July 1, 1946, according to the finding of the Tax Court (R. 156), the three individual petitioners received from the corporate petitioner certain moneys, some during calendar year 1946 and some during calendar year 1947. The Tax Court held that all these moneys (a) were taxable as constructive dividends to the respective individual petitioners (b) for the calendar year 1947 (R., 156, 160).

1. Could the Tax Court properly require the inclusion, in the individual petitioners' respective taxable incomes for the calendar year 1947, income which was received by them during calendar year 1946?

2. a. Should the Tax Court have allowed petitioners credit, for cash expenditures made by them in the purchase of cars, beyond cash expenditures in specific cases that were individually identified by witnesses?

b. Should the Tax Court have made a determination, or required the Commissioner of Internal Reve-

nue to make a determination, of the amount of such a credit?

STATUTES INVOLVED

The relevant statutes provide in pertinent part as follows: Internal Revenue Code of 1939, Sec. 41 (26 U.S.C. Sec. 41)*

Sec. 41. *General Rule*

> The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) . . .

Internal Revenue Code of 1939, Sec. 42 (26 U.S.C. Sec. 42)†

Sec. 42. *Period In Which Items of Gross Income Included.*

> (a) *General Rule*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer . . .

STATEMENT

This case involves the challenge by petitioners of the correctness of findings by the Commissioner of Internal Revenue, as approved by the Tax Court and affirmed by the United States Court of Appeals for the Second Circuit, with respect to deficiencies in the income reported by them, and consequently in the taxes paid on their respective incomes, for the cal-

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* A comparable provision appears in the Internal Revenue Code of 1954 as section 441(a)-(c) (26 U.S.C. Sec. 441(a)-(c)).

† A comparable provision appears in the Internal Revenue Code of 1954 as section 451 (a) (26 U.S.C. Sec. 451(a)).

endar year 1947 in the case of the three individual petitioners, and for the fiscal year beginning July 1, 1946 in the case of the corporate petitioner.

The three individual petitioners were each owners of one-third the stock of the corporate petitioner, which was in the business of buying and selling used cars in Buffalo, New York. The operations of the corporation at the time of the events here involved were carried on by the three individuals as officers, and by employees of the corporation.

For several years ending June 30, 1946, and again from August 1 through November 19, 1946, the business of buying and selling used cars was subject to restrictions imposed by and under the Emergency Price Control Act of 1942 (56 Stat. 23 ff., 50 U.S.C. App., Secs. 901 *et seq.*), as amended, which limited the prices that could be paid or charged by dealers in their purchases or sales of used cars. During and after this period of regulation, however, petitioners found that they were unable to purchase cars at or below the maximum purchase prices established under the Act.* They also discovered that this condition was epidemic throughout the whole area in which they operated.* Faced with the grim choice between losing their livelihood by atrophy and buying the necessary supply of cars at prices over those established under the Act, petitioners were driven by stark necessity to pay more for cars they bought than was allowed under the Act.* So general was this practice at the time that, even by so doing, petitioners were hard put to maintain their stock of cars at the levels necessary to remain actively in business, and had constantly to

* See references to the Record, cited on pages 18-19, *infra.*

improvise ingenious means under great pressure to secure the necessary supplies.*

The state of the market at that time as to retail sales of used cars was in a similar situation. Dealers who paid more than ceiling, for the cars they bought to sell, would obviously not enjoy the margin contemplated under the schedules promulgated under the Emergency Price Control Act if they sold those cars at prices within the ceiling established under the correlative retail sales schedules; in any case, retail purchasers themselves were able and anxious to pay over-ceiling prices to secure used cars, and it was general practice throughout the area for them to do so.* Petitioners joined in the market practices prevalent in the time and place where they were doing business, and accepted prices above those allowed under the Act for cars they sold.*

Under the circumstances, petitioners found it expedient to distinguish the up-to-ceiling from the over-ceiling portions of their transactions. They followed the practice of having their books of account reflect only the up-to-ceiling portion of the purchase prices they paid and the sales prices they charged. As to this portion of their business, petitioners paid for purchases by check, and received money for sales either by check or in cash. With respect to those portions of their purchase or sales prices that exceeding the ceiling, however, petitioners dealt only in cash, and kept no permanent written records. Through their revolving fund they kept cash on hand to cover the over-ceiling portion of their payments for cars, and they accepted cash to cover the over-ceiling portion of

* See references to the Record, cited on page 18, *infra*.

their receipts. It was their experience that, over the months in which they followed this practice, their over-ceiling income and their over-ceiling expenditure maintained an approximate balance.*

Even during the month of July 1946 and after November 19 of that year, when the used car business was not under Government regulation—and, in fact, through the year 1947—petitioners found that the mores developed during the years of regulation had persisted; they had to continue to pay part of their purchase prices in cash additional to a check, and to receive part at least of their sales prices in cash. During this period, accordingly, they continued to operate as they had before, and through this period also they found that their over-ceiling income and their over-ceiling expenditure remained in approximate balance.*

During the course of the trial, the Tax Court declined to hear witnesses offered by the petitioners to show what were the general conditions prevailing in the Buffalo area in the used car business. R. 37-38, 41-42, 72-78. Testimony was given not only as to specific instances of purchase prices paid by petitioners and understated in their records, but also showing that a pattern did exist in petitioners' business practice of paying over-ceiling prices in purchasing cars for their business.* The Tax Court in its opinion, however, used such testimony as evidence only with respect to transactions that were specifically identified and corroborated by petitioners' books, and refused to consider any evidence of petitioners' general business practice.

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* See references to the Record, cited on page 18, *infra*.

The Tax Court found that during the fiscal year beginning July 1, 1946, the corporate petitioner had received from sales more money than was shown on its books, and determined further that the whole amount of this difference was distributed, in equal portions, as constructive dividends to the three individual petitioners. The Tax Court fixed the tax, on the *whole* of each petitioner's share so computed, as part of his income for the calendar year 1947, although the Court itself found that "some part" of this money had been received by the respective petitioners during the calendar year 1946. (R., 160).

REASONS FOR GRANTING THE WRIT

I

This case presents an issue of basic and general importance in cases involving the Federal income tax. That is the issue whether or not, in the words of this Court

> "Income taxes must be paid on income received . . . during an annual accounting period. Cf. I.R.C. Secs. 41, 42; and see *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 369, 363." [*United States* v. *Lewis*, 340 U.S. 590, 592 (1951)].

In the present case, the Tax Court accepted the Commissioner's determinations that the three individual petitioners herein "had received amounts from the corporation during its taxable year which were taxable to them as dividends." R., 156. And the Tax Court expressly stated that "some part" of these dividends "was received in [1946]." (R., 160). This was understating the case indeed, for the whole point of the Government's proof, and of the Court's opinion itself,

was the proposition that the money taken by petitioners from the corporation's revolving fund over the whole course of the corporation's fiscal year was as a practice retained, and was always intended by the three men to be retained, by them personally.*

This decision flies in the face of probably the most fundamental and basic principle of American income taxation. In *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 363, 364-365 (1931), this Court declared:

> "All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions *during a fixed accounting period,* either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt . . . The amount of all [items of income] is required to be included in the gross income *for the taxable year in which received by the taxpayer* . . . See *United States* v. *Anderson,* 269 U.S. 422; *Aluminum Casting Co.* v. *Routzahn,* [282 U.S.] 92." (Emphasis supplied.)
>
> * * * * *
>
> ". . . [The taxpayer's] net income for the period covered by the return . . . is what the statute taxes . . .
>
> * * * * *
>
> ". . . The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more

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* See references to the Record, cited and quoted on pages 13-15, *infra.*

precisely whether the final outcome of the period, or of a given transaction, will be a gain or a loss.

"The Sixteenth Amendment was adopted to enable the government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation. It is not suggested that there has ever been any general scheme for taxing income on any other basis. The computation of income annually *as the net result of all transactions within the year* was a familiar practice, and taxes upon income so arrived at were not unknown, before the Sixteenth Amendment. See *Bowers* v. *Kerbaugh-Empire Co.*, [271 U.S. 170,] 174; *Pacific Insurance Co.* v. *Soule*, 7 Wall. 433; *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U.S. 601, 630. It is not to be supposed that the amendment did not contemplate that Congress might make income so ascertained the basis of a scheme of taxation such as had been in actual operation within the United States before its adoption. While, conceivably, a different system might be devised by which the tax could be assessed, wholly or in part, on the basis of the finally ascertained results of particular transactions, Congress is not required by the amendment to adopt such a system in preference to the more familiar method, even if it were practicable . . . " (Emphasis supplied).

In *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417 (1932), North American had received income, paid to it in 1917 after dismissal by the District Court of a bill brought by the Government attacking the company's right to the money. The dismissal was appealed from to the Circuit Court of Appeals, and

a subsequent appeal taken to this Court was dismissed by stipulation in 1922. In deciding the question in what year the money involved should be considered as income, the Court pointed out that

> ". . . The net profits earned by the property in 1916 were not income of the year 1922—the year in which the litigation with the Government was finally terminated. They became income of the company in 1917, when it first became entitled to them and when it actually received them. If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent . . . If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year . . ." [286 U.S. at p. 424]

In *United States* v. *Lewis*, 340 U.S. 590 (1951), the taxpayer had reported as income for 1944 $22,000 received during that year as an employee's bonus, which he regarded as his own and used unconditionally for his own purposes. In subsequent litigation, however, it was decided that the bonus had been improperly computed and, under the compulsion of a judgment, the taxpayer returned $11,000 to his employer in 1946. The Court of Claims held that the income received "under a mistake of fact" in 1944 was not income during that year. Reversing, this Court said:

> "In the *North American Oil* case we said: 'If a taxpayer receives earnings under a claim of right

and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.' 286 U.S. at 424. Nothing in this language permits an exception merely because a taxpayer is 'mistaken' as to the validity of his claim. Nor has the 'claim of right' doctrine been impaired, as the Court of Claims stated, by *Freuler* v. *Helvering,* 291 U.S. 35, or *Commissioner* v. *Wilcox,* 327 U.S. 404. The *Freuler* case involved an entirely different section of the Internal Revenue Code, and its holding is inapplicable here. 291 U.S. at 43. And in *Commissioner* v. *Wilcox, supra,* we held that receipts from embezzlement did not constitute income, distinguishing *North American Oil* on the ground that an embezzler asserts no 'bona fide legal or equitable claim.' 327 U.S. at 408.

"Income taxes must be paid on income received . . . during an annual accounting period . . ." [340 U.S. at pp. 591-592]

Even in the *Wilcox* case, this Court, referring with approval to the criteria enunciated in *North American Oil,* pointed out that

"For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain." [327 U.S. 404, 408 (1946)]*

* The actual holding in *Wilcox,* that the receipts of embezzlement were not income obtained with a claim of right, was expressly limited to its facts in the contrary holding of this Court later with respect to the receipts of extortion through demands and threats, in *Rutkin* v. *United States,* 343 U.S. 130, 138 (1952), rehear. den. 343 U.S. 952 (1952).

". . . The 'claim of right' interpretation of the tax laws has long been used to give finality to that [annual accounting] period, and is now deeply rooted in the federal tax system . . . We see no reason why the Court should depart from this well-settled interpretation merely because it results in an advantage or disadvantage to the taxpayer...." *United States* v. *Lewis,* 340 U.S. at 592. So firmly established is this doctrine in American tax law that the disregard of its most essential element—that of timing—by the Tax Court in this case constitutes as novel and revolutionary a flight into the unknown as was the balloon ascension at Passy that so amazed Benjamin Franklin in 1783. Such a leap from judicial terra firma as the holding below, by which the Tax Court with one fateful blow shatters into confusion what both majority and minority of this Court have called the "well-established principle that each taxable year is a separate unit for tax accounting purposes" (*Arrowsmith* v. *Commissioner,* 344 U.S. 6, 8, 9-10 (1952)), must not be allowed to escape the restraining scrutiny of this Court.

For clearly, it is no mere oversight, or trivial error, that confronts the Court in this case. The Tax Court made express findings, which drive its holdings on this point into head-on collision with the principles this Court has maintained in *Sanford & Brooks Co., North American Oil* and *Lewis:*

> ". . . Those profits [determined by the Commissioner to have been distributed as dividends 'during 1947' by the corporate petitioner to the individual petitioners herein] represented the understated sales of the corporation which were received in cash and handled through the 'revolving fund.' *Jack, Carl and Morris* [the individual petitioners herein] *received that cash, periodically*

divided it equally among themselves, and at all times had complete control of it. It was not paid out for purchases or other business purposes. All unreported profits of Smiling Jack Chesbro, Inc., for the taxable year [i.e., the corporation's taxable year, beginning July 1, 1946] were thus paid to Jack, Carl and Morris as dividends. [R., 152] (Emphasis supplied).

* * * * *

". . . The corporation had income in excess of the amount reported. Its books fail to show that it retained those additional earnings or spent them for any business purpose. *The three men were the only stockholders of the corporation and had complete charge of and dominion over its funds.* They personally received the amounts from the sale of cars in excess of the prices shown on the books and through that method each retained an equal portion of the additional income of the corporation for the taxable year [i.e., the corporation's fiscal year, beginning July 1, 1946]. No dividends were actually declared but the amounts were taxable as dividends to the three stockholders. . . . [R., 156-157] (Emphasis supplied).

* * * * *

"The evidence clearly shows that the total excess received for cars [by the corporation] over the amounts shown on the books far exceeded the total excess paid for cars over the amounts shown on the books, and those excess profits *went directly into the pockets* of the individual owners of the business. They used the 'revolving fund' to assist them in pocketing the earnings . . ." [R., 158] (Emphasis supplied).

Quite obviously, since the fiscal year of the corporate petitioner herein straddled two fiscal years for each of the individual petitioners, it was incumbent on the Tax Court to make a determination, and a reasonable

determination, as to the distribution of receipt of these dividends by the respective individual taxpayers as between their two taxable years.

But the Tax Court made no such determination, nor any pretense of one, nor even a bow in the direction of an effort to do so. "Although it is fair to assume that some part [of the money] was received in [1946]," its decision states, the "entire amounts" of the constructive "dividends" received by each of the individual petitioners herein shall be taxed "as income to [them] in 1947." R., 160.

Whether this telescoping of time be regarded as mere legerdemain, or be marvelled at as purest phantasy, it upsets previously accepted tax law notions to which this Court has given its unqualified support. The Court of Appeals for the Second Circuit made no comment upon this point, although petitioners raised it before that body, and in this failure to correct the error of the Tax Court petitioners submit the Court of Appeals was mistaken. Put into its simplest terms, the question is whether two calendar years can be squeezed by the Tax Court into one, whether income received during 1946, and required by law to be returned for that year, may be required to be returned as if for 1947 merely because that is a nearby year and counting the two as one will make the computations easier.

The effects of the holding below, if allowed to stand, will obviously be both drastic and widespread, throwing the previously settled law into confusion and raising the most basic problems of tax law construction and interpretation throughout the ten Circuits. This Court should review the holding below that income,

whether received in one year or the next, can be lumped together for tax purposes and required under the law as it now stands to be returned by the taxpayer as if all received during the second year.

II

In *Cohan* v. *Commissioner,* 39 Fed. 2d 540 (C.C.A. 2, 1930), the Circuit Court of Appeals for the Second Circuit enunciated a principle "often cited, never with disapproval" (L. Hand, Circuit Judge, concurring, in *Molnar* v. *Commissioner,* 156 Fed. 2d 924, 926 (C.C.A. 2, 1946)) that the Commissioner may not refuse to allow any part of business expenses which the taxpayer has incurred, merely because the taxpayer is without documentary proof as to the exact amount of such expenditures. The basis of the Court's decision in *Cohan* was as follows:

> "In the production of his plays Cohan was obliged to be freehanded in entertaining actors, employees, and, as he naively adds, dramatic critics. He had also to travel much, at times with his attorney. These expenses amounted to substantial sums, but he kept no account and probably could not have done so. At the trial before the Board he estimated that he had spent . . . fifty-five thousand dollars in all. The Board refused to allow him any part of this, on the ground that it was impossible to tell how much he had in fact spent, in the absence of any items or details. The question is how far this refusal is justified, in view of the finding that he had spent much and that the sums were allowable expenses. Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all

> appears to us inconsistent with saying that something was spent. True, we do not know how many trips Cohan made, nor how large his entertainments were; yet, there was obviously some basis for computation, if necessary by drawing upon the Board's personal estimates of the minimum of such expenses. The amount may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong to refuse any, even though it were the traveling expenses of a single trip. It is not fatal that the result will inevitably be speculative; many important decisions must be such. We think that the Board was in error as to this and must reconsider the evidence." [39 Fed. 2d at pp. 543-544]

Actually, the Board of Tax Appeals had made no stronger finding with regard to Cohan than the Tax Court has done with regard to the petitioners in this case.

In *Cohan,* the taxpayer's situation had been described by the Board of Tax Appeals thus:

> "The next issue is based on the claims of petitioner for deductions for advertising, entertainment and travelling expenses. We can not doubt, upon the record, that petitioner was required to and did spend large sums of money in travelling and entertainment during the period January 1, 1921, to June 30, 1923. There are, however, two obstacles to the allowance of the claims which the record has failed to overcome. One is that *the amounts claimed are bare estimates unsupported by any vouchers or bookkeeping entries of any kind.* The other is that *we do not know what part of the amounts expended were for personal expenses.* In these circumstances we can not say that the respondent erred in disallowing the deductions claimed." *Cohan* v. *C.I.R.,* 11 B.T.A. 743, 761 (1928) (Emphasis supplied).

In the present case, similarly, the Tax Court found that:

> "The Commissioner disallowed deductions claimed for travel and entertainment expenses. No records or receipts to substantiate these items are in existence. They were estimated on the tax returns . . . [R., 152]
>
> * * * * *
>
> "The Court is unwilling to accept the general statements of Jack, Carl and Morris that the understatement of purchases on the books offset the understated sales to a greater degree than is disclosed by the findings of fact . . ." [R., 155]

Yet in this case, as in *Cohan,* there was ample testimony that petitioners had in fact expended significant amounts for travel and entertainment in the course of their business activities. R., 63-66, 69, 120-122. And there was very substantial testimony that petitioners' business was infused with a pattern which involved unrecorded costs to them in even proportion with unrecorded profits; such testimony was given not only by the petitioners themselves (R., 44-47, 60, 62-63, 66-69, 113-120, 123-125, 129-131), but also by other disinterested persons (R., 14-15, 20, 22-26, 30-31, 33-35, 37-38, 42-43, 60-61, 81-85, 87-94, 106-110); the Court itself, in fact, remarked that ". . . I am inclined to be [satisfied] . . . that the used car market at that time was such that they went out and paid over ceiling prices for cars and they sold them for over ceiling prices too, except in rare instances." R., 129. Indeed, the evidence of a pattern was so substantial that the Tax Court, replying to a statement by Government counsel that he did not concede that over-ceiling prices were paid for cars although the corporation's records showed only ceiling prices, remarked:

> "Whether you have conceded that part or not, the evidence is here. The evidence that they very seldom got a car actually at the ceiling price . . ." [R., 138]

Testimony, proffered by petitioners, that precisely this sort of pattern was forced on them by its prevalence throughout the area of their operations, was rejected by the Tax Court. R., 37-38, 41-42, 72-78.

Nevertheless, the Court of Appeals affirmed the holding of the Tax Court on the application of *Cohan* to this case.

The *Cohan* rule has never, so far as petitioners are aware, been approved or disapproved by this Court. Yet its broad scope has caused it to be cited not in one alone but in a number of the Federal Circuits, e.g., *American Range Lines, Inc.* v. *Commissioner,* 200 Fed. 2d 845, 846 (C.A. 2, 1952); *Harris* v. *Commissioner,* 174 Fed. 2d 70, 73 (C.A. 4, 1949); see also *Helvering* v. *Taylor,* 293 U.S. 507, 516 (1935). This Court should review the *Cohan* rule, and pass on its application to this case.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

October Term, 1954

Nos. 158 to 165, incl.

Argued June 15, 1955 Decided August 9, 1955

Docket Nos. 23290 to 23297, incl.

JACK M. CHESBRO, CARL SILVERSTEIN, MORRIS SILVERSTEIN, SMILING JACK CHESBRO, INC., *Petitioners-Appellants,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*

Before CLARK, MEDINA and HINCKS, *Circuit Judges.*

Appeal from an order of the Tax Court of the United States holding petitioners liable for deficiencies in income tax returns and penalties imposed thereon.

Harold Fein, Buffalo, New York, for Petitioners-Appellants.

H. Brian Holland, Assistant Attorney General, Ellis N. Slack, A. F. Prescott, S. D. Hanson, Special Assistants to the Attorney General, for Respondent-Appellee.

PER CURIAM.

We adopt the opinion of the Tax Court. 21 T.C. 123. We add only a few words addressed to the appellants' contention that the Tax Court erred in failing to apply the holding of this court announced in *Cohan* v. *Commissioner,* 39 F. 2d 540. The principal similarity of that case to this lies in the fact that in neither did the taxpayer have books

of account to support the allowance of claimed deductions. But in *Cohan,* the Tax Court was reversed only because it found that the taxpayer had made some allowable expenditures, yet gave him credit for none. That holding is not applicable here. To the extent that the Tax Court found credible evidence to support deductible expenditures, it allowed them, even in the absence of supporting books of account. The evidence offered to prove further expenditures was not such that the Tax Court was obliged to accept it, since it depended on the credibility of witnesses, largely on the credibility of the taxpayers themselves who concededly had long engaged in illegal business activities. That a witness had engaged in practices violative of federal price controls is a factor properly to be considered in judging of his credibility. Nothing in the *Cohan* case holds to the contrary. Here, the decision below was consistent with findings which on the evidence were well within the province of the trier.

Affirmed.

APPENDIX B

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the 7th day of September, one thousand nine hundred and fifty-five.
Present:

HON. CHARLES E. CLARK, *Chief Judge,*
HON. HAROLD R. MEDINA,
HON. CARROLL C. HINCKS,
Circuit Judges.

JACK M. CHESBRO, CARL SILVERSTEIN, MORRIS SILVERSTEIN, SMILING JACK CHESBRO, INC., *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

A petition for a rehearing having been filed herein by counsel for the petitioners,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. DANIEL FUSARO,
Clerk

By
/s/ RALPH C. CURCIO
Deputy Clerk

APPENDIX C

SUPREME COURT OF THE UNITED STATES

No. .....

October Term, 1955

JACK M. CHESBRO, et al., *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for petitioners,

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including

January 6, 1956

/s/ STANLEY REED
Associate Justice of the Supreme Court of the United States.

Dated this twenty-third day of November, 1955.

SUPREME COURT OF THE UNITED STATES

No. .....

October Term, 1955

JACK M. CHESBRO, CARL SILVERSTEIN, MORRIS SILVERSTEIN, SMILING JACK CHESBRO, INC., *Petitioners*

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for petitioners,

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled case be, and the same is hereby, extended to and including

February 4, 1956

/s/ STANLEY REED
Associate Justice of the Supreme Court of the United States.

Dated this twenty-seventh day of December, 1955

In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 665

JACK M. CHESBRO, CARL SILVERSTEIN, MORRIS SILVERSTEIN, SMILING JACK CHESBRO, INC., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 145–159) [1] are reported in 21 T. C. 123. The opinion of the Court of Appeals (Pet. App. 1a–2a) is reported in 225 F. 2d 674.

JURISDICTION

The judgment of the Court of Appeals was entered on August 9, 1955. (Pet. App. 1a.) The

[1] The record citations refer to the separate appendix (record on review) filed jointly in the court below by the four taxpayers involved in these consolidated cases. (R. 145, Pet. App. 1a.)

taxpayers' petition for rehearing was denied on September 7, 1955. (Pet. App. 2a–3a.) By orders of Mr. Justice Reed, dated November 23, 1955, and December 27, 1955, the taxpayers' time for filing a petition for certiorari was extended to January 6, 1956, and again to February 4, 1956, both inclusive. (Pet. App. 3a–4a.) The petition for a writ of certiorari was filed on February 3, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTIONS PRESENTED

The individual taxpayers were the sole and equal stockholders of the taxpayer corporation, which bought and sold used cars. They admittedly falsified their books and income tax returns by understating receipts from sales made in violation of Office of Price Administration ceiling prices. The questions presented are:

1. Whether the Tax Court erred in refusing to accept taxpayers' general unsupported testimony that the understatements of sales prices were fully offset by understatements of purchase prices, and in finding that only a part of the understated sales was offset by understated purchases.

2. Whether the Tax Court erred in finding that income from sales made by the corporation during its fiscal year July 1, 1946–June 30, 1947, admittedly received, retained and divided by the individual taxpayer-stockholders, was taxable to

them in its entirety as dividends received during the calendar year 1947, where taxpayers failed to show what part, if any, was received in 1946.

STATUTE INVOLVED

Sections 22, 23, 41, 42, 54, and 115 of the Internal Revenue Code of 1939 are printed in the Appendix, *infra,* pp. 17–20.

STATEMENT

The pertinent facts as found by the Tax Court (R. 147–152), including by reference (R. 153) the facts (plus exhibits) stipulated by the parties, may be summarized as follows:

The taxpayers are Jack M. Chesbro, Carl Silverstein and Morris Silverstein (hereafter called Jack, Carl and Morris, respectively), and Smiling Jack Chesbro, Inc. (hereafter called the corporation), a New York corporation organized on June 18, 1946. Jack, Carl and Morris, as equal partners, formed the Smiling Jack Chesbro partnership in December, 1945, for the purpose of buying and selling used cars, and continued its operations until June 30, 1946. Their three equal interests therein were exchanged for shares in the corporation when the partnership was dissolved at the end of June 1946, and the corporation, organized to buy and sell used cars, commenced operations on July 1, 1946. The corporation operated on several lots in and around Buffalo, New York, with Morris, Carl and Jack as presi-

dent, secretary-treasurer, and vice-president, respectively, each holding one-third of the stock of the corporation. The corporation used the accrual method of accounting. (R. 147–148.)

Taxpayer Morris operated the Theatre Motor Garage as a sole proprietorship prior to April 1, 1946, when it was succeeded by Theatre Motor Sales, a partnership, consisting of Morris and Carl, which is still in existence and operating. Its main used-car lot, however, became part of the corporation at a time undisclosed by the record. (R. 148.)

Taxpayers Jack, Carl and Morris were engaged at all times material in the business of buying and selling used cars through the various business entities above-mentioned. Their used-car businesses were subject to the restrictions imposed by the then current Emergency Price Control Act of 1942, c. 26, 56 Stat. 23, *et seq.* (50 U. S. C. Appendix, 1952 ed., Sec. 901, *et seq.*), which limited the prices that could be charged for used cars. The regulations promulgated under that Act by the Office of Price Administration were in existence during 1945 and up to July 1, 1946, and thereafter again during the period August 1, 1946, to November 19, 1946, when they went out of existence permanently. The taxpayers were engaged in black-market dealings and many of their sales and some of their purchases were made at prices

in excess of those permitted by the O. P. A. regulations. (R. 148.)

The taxpayers maintained a so-called "revolving fund," begun with cash originally contributed equally by Jack, Carl and Morris, which was used by them to pay overceiling amounts for used automobiles they purchased and was augumented from time to time by the amounts of overceiling prices they received for used cars they sold. No sums in the revolving fund were ever reflected on the books of the taxpayers' several businesses. Occasionally, however, other monies from their various businesses were mingled with those of the revolving fund. Jack, Carl and Morris had access to the revolving fund and kept individual memoranda of their transactions with that fund. The lot managers would get the necessary cash from Jack, Carl and Morris and return extra cash to them. Jack, Carl and Morris would get together every few days and make settlements among themselves for monies taken in and paid out by the revolving fund, and then their individual memoranda of the fund transactions were thrown away. No records were kept of the revolving fund. The revolving fund system was used with respect to the operations of all of the above-mentioned business entities. It was adopted by the taxpayers when the O. P. A. regulations came into effect, and it helped them to evade those regulations by fraud-

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ulently [2] avoiding entries recording the payment or receipt of overceiling prices. Moreover, the taxpayers continued that method of operation and bookkeeping after the O. P. A. regulations went out of existence in November, 1946. (R. 148–149.)

The taxpayers' various businesses kept daily purchase and sales books of original entry, as required by the State of New York, a separate book being kept for each used-car lot. The information for these books, including the name and address of each vendor and vendee and the description of the car and the sales price, was supplied at the main office by Jack, Carl and Morris, and at the other lots by the lot managers. Such information was supplied on O. P. A. forms during the periods of the existence of the O. P. A., and on ordinary slips of paper thereafter. The sales price of each used car, as entered in the books, never exceeded the O. P. A. ceiling price during the periods of O. P. A. price controls. The sales and purchase prices shown on the books after the O. P. A. went out of existence varied in the same way from the actual prices and were determined by Jack, Carl and Morris. No fixed percentage of the actual

[2] The Tax Court found all the taxpayers guilty of fraud and sustained the Commissioner's imposition of 50% fraud penalties against them for all taxable years involved, under Section 293 (b) of the Internal Revenue Code of 1939, and the court below affirmed *in toto*. (Pet. App. 1a–2a.) The taxpayers, however, do not include this issue in their petition.

price was shown in every case. The taxpayers' accountants used those books to make up their various journals and other records as well as the tax returns of their several businesses. The accountants were never told about the additional purchase and sales amounts handled in the "revolving fund" but not entered in the books. (R. 149–150.)

Most purchases and sales were paid for by a combination of cash and check. The check was normally in the amount of the maximum O. P. A. price or the price shown on the books, and the cash represented the overceiling or over-book amount. The checks were shown on the corporation's books and the cash was handled through the revolving fund. The ceiling price was usually entered on the books if only cash was paid. However, checks in the amount of the ceiling prices were sometimes drawn to the order of the vendor, when cash was paid for cars, and the checks were endorsed by someone other than the vendor and cleared through the taxpayers' banks in order to have a record of the purchases as if at ceiling price. There was no fixed ratio between the amounts in cash and in checks that followed through all sales. (R. 150.)

The Commissioner's determination, after adjustments made by stipulation, was that the taxpayers had understated sales in their books in the following amounts (R. 150):

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Smiling Jack Chesbro, partnership	1946	$4,031.00
Smiling Jack Chesbro, Inc	fiscal year ended 6/30/47	97,177.75
Theatre Motor Sales, partnership	1946	11,264.00
Theatre Motor Sales, partnership	1947	7,579.13
Total		120,051.88

The Smiling Jack Chesbro partnership understated certain purchases in the amount of $405 for the year 1946. The corporation understated certain purchases in the amount of $3,973 for its fiscal year ended June 30, 1947. The record shows no other understated purchases. The Smiling Jack Chesbro partnership overstated certain purchases in the amount of $200 and the corporation overstated certain purchases in the amount of $440 for the same periods. (R. 150–151.)

The Commissioner determined that the income of the corporation for the fiscal year ended June 30, 1947, should be increased by $1,950 due to lack of substantiation of checks payable to cash and cash purchases. The record does not show that he erred in that determination. (R. 151.)

The Commissioner also determined that all of the additional profits of the corporation were distributed as dividends during 1947 to Jack, Carl and Morris. Those profits represented the understated sales of the corporation which were received in cash and handled through the revolving fund. Jack, Carl and Morris received that cash, periodically divided it equally among themselves, and at all times had complete control of it. It was not paid out for purchases or other business purposes. All unreported profits of the

corporation for its taxable year ended June 30, 1947, were thus paid to Jack, Carl and Morris as dividends. (R. 152.)

The taxpayers conceded in the Tax Court that the gross receipts from the sales of used cars were understated in their books of account and tax returns for all their businesses for the taxable years involved, both before and after the O. P. A. ceiling prices were in effect, and they neither showed error in nor attacked the total amount of these admitted understatements of unreported income, as determined by the Commissioner, after adjustments by stipulation, and redetermined and found by the Tax Court in the total sum of $120,051.88 for those years. (R. 150, 154.) Moreover, the Tax Court rejected, for failure of proof, the taxpayers' contention that—even with no support in their falsified records—it was obliged to accept their oral testimony that their asserted understatement of purchase prices for used cars was "substantially equivalent" to their admitted understatement of sales receipts. (R. 154–155.)

On the basis of the foregoing facts, the Tax Court (a) charged all the taxpayers, individual and corporate, with income to the extent of the admitted understated sales receipts which were neither recorded on their books nor reported on their tax returns, and disallowed—to the extent not substantiated by credible evidence—their asserted understatement of purchase prices claimed to have been comparable to their conceded under-

statement of sales receipts for all taxable years involved (R. 154–155), and (b) held that the three individual taxpayers each received during 1947 a dividend of $30,814.02 from the corporation in which they were the only stockholders (R. 156–157). The court below affirmed as to both issues. (Pet. App. 1a–2a.)

ARGUMENT

This case turns upon factual questions which were decided adversely to the taxpayers by both courts below. The concurrent findings of those two courts are fully supported by the record and are entitled to finality here. There is no conflict of decisions and no occasion for further review.

1. The taxpayer-stockholders concededly sold used cars on behalf of the taxpayer corporation in violation of O. P. A. ceiling price regulations, and concededly falsified the corporate and individual records and tax returns by understating the amounts of the sales proceeds. At the hearing before the Tax Court they sought to explain the discrepancy between the total amount actually received and the total amount of income recorded and reported, and thereby overcome the presumptive correctness of the Commissioner's deficiency determination, by general testimony to the effect that they had understated the purchase prices of the cars sold in amounts comparable to the understatements of sales prices. However, except for a few specific instances, as to which the

Tax Court made findings in taxpayers' favor, their testimony on this score was vague, uncorroborated, and indeed contradicted by their own records. Moreover, as the Tax Court also pointed out (R. 155), the Commissioner affirmatively proved that in four transactions the purchase prices had been overstated on the books, and that in 59 transactions the actual purchase price corresponded with that shown on the books. Under the circumstances the Tax Court was fully justified in refusing (R. 155) "to accept the general statements of [the taxpayer-stockholders] that the understatement of purchases on the books offset the understated sales to a greater degree than is disclosed by the findings of fact", and in holding that taxpayers had failed to meet the burden of proof which rested upon them.

Affirmance of the Tax Court's conclusion by the court below was clearly in accord with settled principles. The issue is purely one of fact, and under familiar rules respecting the scope of judicial review of the Tax Court's decisions it is the function of that court to weigh the evidence, pass on the credibility of witnesses, find the facts, and draw inferences from the facts. *Wilmington Co.* v. *Helvering,* 316 U. S. 164; *Commissioner* v. *Scottish American Co.,* 323 U. S. 119. Clearly, the trial court is not obliged to accept general uncorroborated testimony, even in the absence of direct conflicting testimony, where it is inherently implausible or lacks credibility. *A*

fortiori, it is not required to do so where, as here, the testimony is contradicted by other evidence. *Quock Ting* v. *United States,* 140 U. S. 417, 420–422; *Cohen* v. *Commissioner,* 148 F. 2d 336 (C. A. 2d); *Andrew Jergens Co.* v. *Conner,* 125 F. 2d 686 (C. A. 6th).

Taxpayers mistakenly claim that the decision departs from the rule enunciated by the court below in *Cohan* v. *Commissioner,* 39 F. 2d 540 (C. A. 2d). It was there held that the Tax Court should have allowed the taxpayer to deduct some amount of claimed expenses, however small, where it found that he had made some deductible expenditures but had failed to prove the amount. However, as the court below pointed out (Pet. App. 1a–2a), its holding in that case has no applicability here, since in this case the Tax Court did allow amounts claimed by taxpayers to have been expended as the purchase price of goods sold to the extent that it found credible evidence to support such expenditures, and it did so even in the absence of supporting books of account.

2. The court below also properly sustained the Tax Court's determination (R. 156–157, 160–161) that the unreported corporate income for the corporation's fiscal year ended June 30, 1947—the conceded understated sales receipts of the corporation which the stockholder-taxpayers received, retained, and divided in equal shares—was taxable to them as dividends constructively received

in 1947.[3] Although the propriety of taxing any portion of this corporate income to the stockholders was at first challenged by them (R. 156), they subsequently abandoned that position. Instead, they contended upon a motion to vacate the Tax Court's decision (R. 160), as they do here (Pet. 3, 15), that part of the income was received and taxable in 1946 and that consequently it was error to hold that all of it was received and taxable in 1947. The Tax Court denied the motion on the ground that the taxpayers "have not shown what part of the total was actually received in 1946, although it is fair to assume that some part was received in that year" (R. 160); and on the further ground that "neither the Commissioner nor the Court could tell what the amounts represented until the close of the fiscal year of the corporation when it became apparent that the individuals intended to retain the overceiling sales prices which they had not turned in to the corporation." (R. 161.) In the absence of satisfactory evidence upon which an allocation of the receipts as between the years 1946 and 1947 could be made, the Tax Court was clearly justified in holding that the taxpayers had failed to meet the burden of proving the Commissioner's determination to be incorrect, and the court below was equally justi-

[3] While the corporation reported its income on the basis of a fiscal year ended June 30, the individual taxpayers reported their incomes on a calendar year basis. (R. 146.)

fied in affirming. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590, 594.

There is no warrant for taxpayers' assertion (Pet. 8–9) that the courts below disregarded the principle of annual tax accounting, and the cases upon which they rely for conflict in this connection (Pet. 10–14) are patently inapposite. The question in those cases was whether a taxpayer who receives income in one year under a "claim of right" is required to report the income in that year, even though he may be required to restore the income in a later year, and it was held that the income must be accounted for in the year received. No such question is presented here. The only issue here is what part of an amount concededly representing income in the year it was received was actually received in 1946, and what part was actually received in 1947. In the absence of evidence from which an apportionment could be made, the Tax Court's determination that it was all received in 1947 should not be disturbed.

Moreover, as the Tax Court also held (R. 161), since the corporation's fiscal year ended on June 30, 1947, it could not be known with certainty until then whether there were dividends available for distribution. In the circumstances of this case, where the truth had to be dug out from under the extensive frauds of the taxpayers (a point they no longer dispute, fn. 2, *supra,* p. 6), it was clearly proper to charge them with this

income, under settled accounting principles, in 1947.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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MARCH 1956.

APPENDIX

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Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(e) *Distributions by Corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any

trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 42.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for

the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) [As amended by Sec. 166, Revenue Act of 1942, *supra*] *Definition of Dividend.*—The term "dividend" when used in this chapter (except in section 201 (c) (5), section 204 (c) (11) and section 207 (a) (2) and (b) (3) (where the reference is to dividends of insurance companies paid to policy holders)) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribu-

tion shall be applied against and reduce the adjusted basis of the stock provided in section 113.

* * * * *

(26 U. S. C. 1952 ed., Sec. 115.)

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